

Enhanced EU FDI screening proposed by European Commission

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On January 24, 2024, the European Commission announced a package of initiatives to strengthen the EU's economic security, including a series of proposed changes to the EU foreign investment screening regulation.

The announced package¹ includes a proposal for a new EU Foreign Direct Investment Screening Regulation (the FDI Regulation).² The European Commission (the EC) key proposed changes focus on three areas: (i) ensuring all EU Member States have in place FDI screening mechanisms, with improved harmonisation across regimes; (ii) extending FDI screening to indirect acquisitions of EU businesses by non-EU investors; and (iii) establishing a list of sectors subject to FDI scrutiny due to their strategic importance.

Strengthening foreign investment screening

1. Ensuring all EU Member States have an FDI screening mechanism in place and harmonising national rules

All EU Member States will be required to adopt national FDI regimes. Currently 22 of the EU's 27 Member States have national FDI Regimes, with Ireland's regime due to enter into force by mid-2024. The remaining four EU Member States,³ have all taken steps to introduce screening mechanisms without a clear timeline to their implementation.

The EC also proposes to harmonise EU Member States' FDI rules establishing: (i) minimum standards, including common procedural rules, (see below);⁴ (ii) confidential information protections; and (iii) annual reporting obligations.

In addition, the EC proposes to strengthen cooperation between EU Member States where multiple reviews are ongoing, as well as imposing a requirement on merging parties to submit all notifications to EU Member States' FDI regimes on the same day.

2. Extension of the FDI Regulation to indirect acquisitions of EU businesses by non-EU investors

The current FDI Regulation catches investments in companies by EU investors that are directly owned or controlled by non-EU entities. As recently confirmed by the EU Courts,⁵ it does not capture investments in the EU made by EU Companies which are ultimately controlled by a non-EU investor. The EC's proposal bridges this gap.

3. Establishing a list of sectors that must be subject to FDI scrutiny due to their strategic importance

The proposed FDI Regulation identifies areas of economic activity where investments would require mandatory pre-close screening, including critical technologies, such as semiconductors and AI technologies, critical medicines and

biotechnologies, and certain activities in the financial sectors, such as payment systems and crypto asset service providers.

Further, the proposed FDI Regulation identifies certain investors who would need to submit a filing, including: (i) non-EU governmental-controlled investors; (ii) sanctioned investors; and (iii) non-EU investors who have previously not been authorised or authorised under conditions.

Any investments in strategic sectors where an in-depth investigation is launched by an EU Member State would also need to be notified to the EC and other EU Member States. The same applies to investments where the EU Member State in which the target is located believes it could be of interest to other EU Member States and the EC from a security or public order perspective.

Consultation on an outbound investment regime

The package of initiatives includes a white paper on establishing an outbound investment screening regime, which will investigate the potential security risks arising, with a view to understanding existing gaps in the EU's trade and security tools, and proposing appropriate remedies.⁶

This is in step with both the UK's and US' recent announcements on possible outbound investment regimes.⁷ These parallel initiatives are likely to be informed by how regimes take shape in the other jurisdictions.

These proposals, if adopted, will add further complexity to regulatory risk assessments for deals with a European element and impose additional regulatory hurdles on EU-based investors. Deal teams should take account of the increasing regulatory burden and consequent execution risks at an early stage in deal planning and design regulatory engagement strategies to maximise prospects of securing prompt clearance decisions.

How does this fit alongside other European Regulations? The addition of new FDI regimes and the broadening of the scope of existing regimes means that transacting parties may now have to manage three parallel sets of filings with: (i) merger control regulators; (ii) multiple FDI regulators; and (iii) EU Foreign Subsidies Regulation⁸ filings. The EC has signalled that it is unlikely that they can align the timetables between these regimes, noting that each regime serves a different use case.

How soon could these changes come into effect? The proposal will need to pass through the European legislative process. EU Member States will then have a further 15 months to implement those changes, meaning that the changes are not likely to be in effect for at least two more years.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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- ¹ *Commission proposes new initiatives to strengthen economic security*, European Commission (January 24, 2024), https://ec.europa.eu/commission/presscorner/detail/en/IP_24_363.
- ² Following a review of more than 1,200 transactions collectively by EU Member States and the European Commission over the past three years under the current FDI Regulation.
- ³ Bulgaria, Croatia, Cyprus, and Greece.
- ⁴ Such as right of appeal and mandatory pre-close screening of particularly sensitive deals.
- ⁵ *Xella Magyarország*, European Court of Justice (13 July 2023), <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62022CJ0106>.
- ⁶ The public consultation will run until April 2024, after which the EC will publish its recommendation, triggering a 12-month review of outbound investments completed since 1 January 2019 by various EU agencies.
- ⁷ *Biden administration releases initial proposal for outbound foreign investment rules targeting China*, Davis Polk (August 10, 2023), <https://www.davispolk.com/insights/client-update/biden-administration-releases-initial-proposal-outbound-foreign-investment> & UK government issues a policy paper addressing the national security risks posed by certain types of outbound investment (June 21, 2023) <https://www.gov.uk/government/publications/the-atlantic-declaration/addressing-the-national-security-risks-posed-by-certain-types-of-outbound-investment>.
- ⁸ *New EU Foreign Subsidies Regulation starts to apply*, Davis Polk (July 12, 2023), <https://www.davispolk.com/insights/client-update/new-eu-foreign-subsidies-regulation-starts-apply>.